
Studies in Employment and Social Policy

In the series Studies in Employment and Social Policy this book
*Contractualism in Employment Services: A New Form of Welfare State
Governance* is the twenty-ninth title.

The titles published in this series are listed at the end of this volume.

8

Studies in Employment and Social Policy

**Contractualism in Employment
Services**

**A New Form of Welfare State
Governance**

Edited by
Els Sol and Mies Westerveld

KLUWER LAW
INTERNATIONAL

CHAPTER 1

Contractualism in Employment Services:
A Socio-Economic Perspective

HUGH MOSLEY & ELS SOL

The use of contracting as an instrument of policy implementation is spreading rapidly in employment services, a domain that for decades has been tightly linked to government provision, at least in Europe. Increasingly the state is withdrawing from the direct provision of goods and services in favour of more market-oriented types of intervention (Mayntz, 1983; Schmid, O'Reilly, & Schömann, 1996). Yeatman (1995, 1997) uses the term 'new contractualism' to denote this trend. New contractualism refers to the increased use of contracts as a key tool in the regulation of public relationships (Carney & Ramia, 2002, p. 26). It is part of the broader neo-liberal tendency to marketise and individualise relationships. The term neo-liberalism denotes a form of political-economic governance based on the centrality of market relationships. The responsibility for conduct of life is increasingly transferred to solitary actors. All actors find themselves confronted by the demand that they develop a rational self-concept as a 'self-regulating subject', in other words, as an 'entrepreneur'. The individual 'is no longer construed as a social creature seeking satisfaction of his or her need for security, solidarity and welfare, but as an individual actively seeking to shape and manage his or her own life in order to maximise its returns in terms of success and achievement' (Miller & Rose, 1990, p. 26). Contractualism refers, according to Yeatman, not merely to a set of isolated examples of the use of contracts in various arenas but to a new public policy regime in its own right.

By making a direct link between contracts and neo-liberalism — Yeatman even speaks of 'post-liberalism' — it appears, from this point of view, that the institutional context of a country with its established practices and historical traditions is being inevitably displaced by a liberal, contractual regime with a market-based approach at its

centre. The contractualist model becomes a universal organising principle for public reform. The delivery of public services by decentralised agencies is replaced by a so-called quasi-market in which the services involved remain publicly funded and subject to a regulatory framework set by government.

The spread of contracting in governance is facilitated by its close connection with the agenda of managerialism, which aims to make management the driving force of a competitively successful society. As part of the new contractualist agenda in public administration, forms of managerialism rooted largely in the theoretical framework of New Public Management have been introduced in the public sector (Hood, 1991). New Public Management, with its self-proclaimed universal relevance, entails the closer alignment of public sector governance with that of the private sector, introducing (quasi) market imperatives into the operation of the public sector and calling forth changes in its structure, ownership and management techniques.

In this chapter we discuss the rise of contract-based relations in public sector reforms. First, we present a theoretical analysis of contract relations in employment service provision. In the second section we distinguish governance regimes and different meanings and uses of contracting, giving particular attention to contracting-out, and discuss three principal types of contracting in the provision of employment services. Finally, we identify key questions to be elaborated in the country studies in the second part of the book and summarise the structure of the book.

REFORM IN EMPLOYMENT SERVICES: A THEORETICAL PERSPECTIVE

The shift from a traditional hierarchical governance structure towards a contract-based governance structure is evident in many countries, developed as well as developing (cf. World Bank, 1995).¹ Despite this wide dissemination there is no uniform pattern. Under the umbrella of what is usually referred to as New Public Management, there is not a single, coherent theory of the public sector but various - sometimes even conflicting - theoretical perspectives (Ramia & Carney, 2000). Important among these has been public choice theory, which offers a framework using (economic) rationality in decision-making as the main criterion, and the so-called new institutional economics, which highlights the problem of transaction costs. In addition, managerialism draws on agency theory, which focuses on the law and policy considerations surrounding the relationship between a principal, the party who initiates contractual relations, and the agent, who performs a function for the principal in return for compensation. Key concepts in these approaches are efficiency, the purchaser/provider split, performance management, contract management and accountability.

¹ The governance concept is used in an overarching, general sense. See Mayntz, 2004.

Transaction cost approach

The issue of when contracting-out is appropriate is addressed at a more theoretical level in the transaction cost approach of new institutional economics (Williamson, 1985). Two characteristics of transactions are considered to be of central importance for the choice of form of governance: uncertainty and transaction-specific investment. As a rule, the higher the level of uncertainty in a transaction, the more difficult it is to regulate it through a contract with an external provider because the terms and conditions of the transaction cannot be adequately specified in advance. Even more important is the existence of transaction-specific investments, which increase the risk of opportunism. In general, high transaction-specific investments are an obstacle to outsourcing (Barney & Hesterly, 1996).

It is difficult to apply an analysis of this level of generality to the practical question of which welfare state or labour market services should best be provided 'in house' or contracted out. In practice, therefore, there has been a gradual substitution of outsourcing for Public Employment Service (PES) in-house training facilities over the last two decades in many countries. Placement services appear to be the last core service that is provided directly by the PES in most countries. However, in this case, too, there is a clear trend towards the contracting-out of placement activities for special groups such as the long-term unemployed and social assistance recipients. Moreover, in the recent reform of the Australian PES, and to a lesser extent in the Netherlands, contracting out to external private providers is the usual form of service provision. New is the use of competitive tendering and the use of for-profit providers for the implementation of these services.

In practice such institutional choices are strongly shaped by national institutional traditions (path dependency) and are made incrementally through learning from the experience of other agencies or countries or, in some cases, through 'market testing' (e.g. the United Kingdom). Institutional choices in implementation strategies reflect, moreover, international trends in public service reforms (e.g. New Public Management) and ideological currents (e.g. neo-liberalism). Although justified in functional terms (e.g. superior efficiency of private provision or of markets), there is seldom unambiguous evidence for such claims.

Transaction cost theory does, nevertheless, provide some important insights. For example, an external provider may be unwilling (or unable) to make large investments in facilities or skilled staff to provide highly specialised training (transaction-specific investments) on a (short-term) contract basis. Similarly, output-oriented contracting that pays providers of labour market services on the basis of the results they achieved (usually, entry of clients into employment) is subject to grave uncertainties regarding the development of the labour market and business cycle, which no provider can foresee. In such cases contracting-out requires payment of a risk premium, which may in fact result in the cost of services being higher than under a comparable public provision of services.

The existence of market failure is a traditional argument for public intervention (in whatever form) to secure desired public outcomes. To a certain extent, similar

considerations may place constraints on the contracting-out of employment services. Employment services are not highly standardised commodities but 'tailor-made' to fit a local clientele and labour market conditions: they have to be provided locally. Competition in markets for employment services may in fact be very limited due to the small number of potential local providers.

Agency theory

Agency theory provides an additional framework for analysing the functional problems of contracting in service provision. In agency relationships one partner to the transaction (the principal) delegates authority to another (the agent), and the welfare of the principal is affected by the choices of the agent (Arrow, 1985). The agency relationship is problematic for the principal because the interests of principal and agent diverge and because the principal cannot perfectly and without costs monitor the agent's actions and the information available to the agent. Arrow (1985) identifies two principal types of opportunism in the agency relationship: adverse selection and moral hazard. Adverse selection is a type of opportunism which develops before two parties have actually begun an exchange and arises when the principal is not fully informed about the abilities of the potential agents, and therefore may make an unwise agent choice. Whereas adverse selection is pre-contractual opportunism that exploits asymmetric information about future performance, moral hazard is post-contractual opportunism that exploits asymmetric information about current performance. Moral hazard develops once the contract has been agreed to, in a relationship in which the principal cannot directly observe the agent's actions and in which efforts to determine these actions are both costly and subject to error. The agent, realising the informational advantage, does not meet the terms of the contract (Barney & Ouchi, 1986, pp. 439-440; Ferris & Graddy, 1996, p. 3).

Because of asymmetric information, contracts are mostly incomplete. With the assumption of complete contracts, which much of the privatisation literature has taken (Hart, 2003), the structure of ownership is not important. Government objectives — economic or otherwise — can be achieved by means of a detailed initial contract (at least for the things that can be specified). However, if contracts are incomplete, as they are in practice, ownership does matter. From the perspective of incomplete contracting, the owner of an asset or firm can make all decisions about the asset or firm which are not included in an initial contract (the owner has 'residual control rights'). Especially in the case of 'soft' services like employment services, with its diversity of clients and difficulty of assessing the quality of services, being the one that makes all the necessary decisions can be important. Usually the government has broad social objectives with respect to these services — objectives that go beyond the provision of an efficient service. The most important of these is equity or fairness: society has decided that, for one reason or another, these services should be distributed equitably among its members (Le Grand, 2002). As a result, it is difficult for the (public) principal to know whether (private) agents act in conformity with the public interest. For example, because of the

difficulty of assessing quality of service, quality may be sacrificed to achieve cost savings by a private entity (Hart, Shleifer, & Vishny, 1997; King & Pitchford, 1998). This possibility can make politicians and public policymakers feel hesitant about letting their decision-making power slip.

Agency theory provides a useful framework for analysing the functional problems in employment service implementation regimes that rely heavily on contract models. For example, Courty and Marschke (1996) found that output-oriented contracting with training providers in U.S. Job Training Partnership Act programmes induced gaming behaviour and the problem of moral hazard: 'actions which cannot be eliminated contractually ex ante and which the principal cannot detect ex post' (p. 157). 'Gaming' the performance measures was defined as taking action, at the expense of the organisation's objectives, that increases reported performance without improving actual performance (Courty & Marschke, 1997). In this case contractors were compensated on the basis of the post-programme employment status of their clients. Training providers used the discretion available to them to manipulate the timing of exits from the programme to coincide with placements, which frequently were short-term jobs. Courty and Marschke estimate that this practice inflated reported training centre performance by about 20%.

A special case of adverse selection in labour market policy programme implementation is the well-known phenomenon of 'cherry picking' or 'creaming', that is, the selection of those persons eligible for labour market programmes who, due to personal characteristics (qualifications, attitude, etc.), can be prepared in the shortest possible time to achieve programme goals. In this case the selection of programme participants is based on knowledge unavailable to the principal. It is a problem in all labour market programmes but is particularly likely to occur where performance assessment or even performance-based compensation is incorporated in contracts or quasi-contracts.

Agency problems are not limited to control of the agent. In practice, failure by the principal is of equal importance in contracting-out. The responsible agency (a) must have the expertise to specify in a tender document the needed services to be provided of a certain type, for certain groups, in a specific labour market; (b) must be able to assess the quality and price of the bids submitted and their reliability; (c) must have the capacity to monitor and assess contract performance by external providers and feed this information back into the next contracting cycle. Where these prerequisites are lacking, which is too often the case, the results will be suboptimal (De Koning, 2004).

GOVERNANCE REGIMES AND DIFFERENT MEANINGS AND USES OF CONTRACTING

Following International Labour Organization guidelines, European welfare states for a long time emphasised the virtues of in-house delivery of employment services. This is not to say that there was little or no contracting in Europe. On the contrary, there is a long history of outsourcing employment services by PES — as a 'niche' in a world of

hierarchical coordination — motivated mainly by management principles (e.g. lack of capacity for specialised services). What is new is that currently, in a number of countries, central policymakers are using contracting as a policy tool to construct new institutional relationships between governments, public servants, providers and clients. Once the scale of contracting reaches a certain point of transformation, previous relations in the domain of employment services are restructured. In theory, traditional PES bureaucracy gives way to forms of market coordination as a new kind of governance, in which public officials no longer understand their work as following rules and procedures but come to organise their activities and choices through prices and outcome payments.

We can identify four models of publicly funded employment service regimes (see Table 1.1). Each has different modes of employment service provision, with different roles for the PES and alternative service delivery strategies. In all but the first model policymakers use contracts as central steering instruments in place of bureaucratic administration. The first is a classic bureaucratic PES service provision model with rules as the form of control. Policy and implementation is the task of a single public actor, the PES. The relationships between the government and the PES and between public organisations and clients are regulated by rules. For niche markets, specialised services are outsourced to private non-profit providers, typically in a subordinate relationship. In the Management By Objectives (MBO) model, a principal-agent contract relationship is introduced within the public sector through internal service provision contracts within the PES, mimicking regular contracting. In this model we also find outsourcing for specialised services, such as vocational training by private providers (see page 7).

In the quasi-market and preferred-supplier models a re-integration market with private for-profit and non-profit providers is introduced. The PES no longer plays a central role. In these models, public as well as private service deliverers operate in a 'quasi-market' on equal terms. The term 'quasi-market' captures the qualitative difference between competition in welfare and commodity production. The quasi-market is profit-driven but — unlike in the real market paradigm — the state is the purchaser through public funding. The real customers in the quasi-market of welfare, the clients, generally do not pay for the employment services (and generally are not able to pay). Moreover, the clients are on benefit and thus do not use the services voluntarily. Under the quasi-market model, competition is created through tendering. In the preferred-supplier model, government opts not for a competitive market for services but for a procurement system with preferred suppliers, combined with a tender system for a small portion of the market. The Australian model, originally a market regime, is developing in this direction. In Australia we find policy bureaucrats, government ministers and dominant contractors empowered to steer an implicit bureaucracy. This approach operates on the basis of powerful financial incentives shielded by strong public regulation (Considine, 2003). An advantage of continuing contracts with well-functioning providers is the reduced administrative (transaction) costs of tendering for both the principal and the providers.

Table 1.1
Four Models of Employment Service Provision

	<i>PES role</i>	<i>Contract as steering instrument</i>	<i>Competition in service delivery</i>	<i>Service provision strategy</i>
Bureaucratic model	Strong	No	No & outsourcing in niches	Public
Management By Objectives model	Strong	Yes	High internal & outsourcing in niches	Public
Market-based:				
Quasi-market model	Weak	Yes	High	Private: for-profit/non-profit
Preferred-supplier model	Weak	Yes	Low	Private: for-profit/non-profit

Furthermore, in the more stable market structure of preferred suppliers, the suppliers can improve quality and innovation of service. One disadvantage, when compared with the classic quasi-market model, is that barriers to entry are higher for

In fact, the public market is an idealised world; most advanced systems in the social policy field actually constitute a hybrid made up of market and administrative instruments. For example, in a country such as the United Kingdom, with an MBO model and a PES in a strong position, a quasi-market model is used for long-term unemployed persons in so-called Employment Zones. And in countries with market-based models, public steering is often based on an MBO model. The trend towards the use of contractual forms in welfare-state governance is in practice extremely diverse. Countries can develop their own distinctive profile shaped by path dependency, that is, historical traditions, cultural norms and established practices (Rhodes, 1999).

The contractual models discussed above relate to collective contracts between collective actors. But responsibility for conduct of life is increasingly being transferred to new providers, individual actors as well. This development is reflected in the growth of vouchers and client contracts. Client contracts are used in most countries, under several different names: jobseeker's contract, jobseeker's agreement, individual action project and personal action plan (Handler, 2002). A variety of arrangements are set out in the client contract. Clients contracts can regulate all kinds of relations: between the

individual and the government, the PES or another provider. Individual client contracts can be interpreted both in a symbolic and in a legal sense. Used symbolically, 'contract' emphasises the reciprocal character of the legal relations. A number of questions arise with respect to such contracts, such as those related to enforceability, accountability and the issue of freedom of choice.

In principle, the contractual arrangement can be beneficial to both parties. For the jobseeker, its advantage lies in the fact that a well-formulated contract forces the service provider to be explicit in its expectations towards the client. A contract may also provide for personal choice, for instance — in a privatised setting — between several service providers. Yet there are also grounds for criticising this use of contracts. For instance, Joel Handler regards such contracts as merely an attempt to put a human face on changes intended to turn the welfare state from a passive provider of income support to a promoter and monitor of individual activation. The notion that government can help the socially excluded through contracts based on individual needs is, in his opinion, a myth (Handler, 2002, p. 40).

On the basis of the different models of public employment service provision, combined with the double-actor perspective (individual/collective), three important contract types can be discerned, which are key objects of research in this volume. First, *government internal contracts*: these public contracts include performance agreements between the government (or responsible ministry) and the PES or between the PES and its regional units, as well as public contracts governing the devolution of responsibilities from the national government to state or provincial governments in federal systems. These contracts within the public sector are also referred to as performance agreements (Davies, 2001). Because they usually are not legally binding arrangements, they are 'quasi-contracts'.

Second, *market-based service provider contracts* are contracts made by the government with private for-profit and non-profit service providers through the use of contracting-out. Public actors also can be involved, but on the same conditions: they must act as a private provider. The public employment service organisation — that is, the PES, the former in-house service provider — sometimes acts as one of the service providers. Tenders can be open to all or not, and different combinations are possible. Competitive tenders can be combined with procurement. In Australia, for example, the government contracts out partly on the basis of competitive tender, partly on the basis of procurement; part of the budget is for contractors with good performance ratings, who are offered contracts again in the next contract cycle.

Third, *client contracts* are contracts between (public or private) service providers or benefit agencies and individual clients, usually setting forth the terms of re-integration agreements and their rights and duties. For example, contracts between PES counsellors or private providers and individual jobseekers belong to this contract type. In a subtype of this contract form, eligible clients can receive a voucher that can be spent only on training, placement or both. The individual client contract is discussed from a legal perspective in Chapter 2. In the remainder of this section we discuss the key characteristics of the major contract types.

Government internal (PES) contracts

Contracting between the government and the implementing public agency and between the public agency and its subordinate operating units reflects in particular the influence of performance management, which aims to replace 'administrative culture' and its input-based model of public administration with a 'management culture' (Richards, 1994) using a quasi-contractual paradigm adapted from the private sector (Osborne & Gaebler, 1992). For contracts to be used in an efficient and effective manner, performance measures are vital. In the publicly funded employment services, performance management — the attempt at improving performance through performance measurement coupled with incentives, alongside contracts, has been a major driver of change in recent years. The principal needs to renew or discontinue contracts with service providers according to the estimated net impact of their services, that is, gross outcomes relative to a 'benchmark' or 'target' level, like in MBO systems. Mosley, Schütz and Breyer (2001) reported that 10 out of 18 European Union PES organisations were using MBO methods. The basic elements of the MBO governance model can be summarised as follows:

- **Goal definition and performance indicators:** The first step in the management cycle is the establishment of clear goals, operational objectives (targets) and the development of corresponding performance indicators capable of measuring the extent to which these targets have been achieved.
- **Delegation:** Delegation of objectives and resources, in manageable units, to staff at subordinate levels of the organisation.
- **Flexibility:** There is a low density of generally binding rules and procedures. Managers and operating units at regional and local levels are free to allocate resources flexibly between budget items, in order to vary their policy mix, and even to allocate programme design features (e.g. eligibility requirements, implementation structures).
- **Monitoring of performance against targets:** MBO requires sophisticated management information systems that regularly measure the progress of indicators towards agreed targets. Moreover, 'real-time' monitoring enables managers to intervene immediately in case of under-performance (i.e. stronger deviations from the 'target track').
- **Performance assessment:** A final performance review at the end of a management cycle is another important component of MBO. At this stage the performance of the operating units is assessed by the next supervisory level. In contrast to traditional bureaucratic administration, the emphasis is on outputs or outcomes as measured against targets rather than on controlling inputs and adherence to detailed regulations.
- **New policy cycle:** On the basis of the performance assessment policy goals, operational targets and performance indicators are redefined or adjusted for the next policy cycle.

In contrast to the emphasis in traditional public sector governance on legal and fiscal accountability, the central accountability mechanism in MBO is the contract or 'quasi-contract'. Contracting is usually at two key levels: on one level, a contract or agreement with the responsible ministry specifies the organisational goals and targets of the PES to be achieved within a given time period and (in some cases) the resources available. For example, in Great Britain the Employment Service (since summer 2002, Jobcentre Plus; see Finn, Chapter 5) concludes an annual Agency Performance Agreement with its department, setting forth the targets to be achieved in the current fiscal year and the indicators to be used to assess performance. Similar measures are taken in public employment agencies in other countries, such as the Flemish Public Employment Service in Belgium (see Struyven & Verhoest, Chapter 15) and the National Employment Agency in France (see Barbier, Chapter 12). At the next level, this national agreement becomes the basis for a series of internal agreements between the agency and each of its regional offices and between the regional offices and the district offices for the achievement of specified targets in the delivery of government programmes.

Progress towards agreed targets is monitored by the management information system on a weekly or monthly basis. The comparison of tracked results with targets is the basis for performance assessment in the internal accountability relationships between different levels of the organisation and between the agency and its ministry (Mosley, Schütz, & Breyer, 2001, p. 45).

Governmental-sector intra- and inter-agency agreements are called 'quasi-contracts' because they are seldom legally enforceable: the parties to the agreement (here between government and agency or between different levels of the same agency) are in most cases not legal persons. They serve merely to coordinate activities and provide an accountability framework that assigns responsibility, reporting requirements and accountability standards in terms of which compliance is to be assessed (Davies, 2001, p. 41). From a legal point of view, these agreements are sometimes regarded as being merely symbolic: 'In effect, the contractual relationship is simply a hierarchical management relationship with a greater degree of formality about the aims to be pursued' (Davies, 2001, p. 56). However, when rooted in the culture of organisations and backed by implicit or explicit rewards for managers and other personnel (e.g. bonuses, promotions, distinctions), they can be real and effective instruments of governance. Sanctions, which usually are weak, are in any case less important than the motivation of staff and their identification with the organisation and its goals (Mosley, Schütz, & Breyer, 2001).

Apart from contracting between government and the implementing public agency and between the public agency and its subordinate operating units, public sector contracting also plays an important role in welfare-state policy implementation in *multi-level governance*. Political decentralisation, or multi-level governance, entails not merely managerial decentralisation, like that propounded in MBO, but a more far-reaching delegation of responsibility for labour market policy from the national to the sub-national levels of government (regional, provincial, state or municipal), especially in federal systems (e.g. Canada, the United States, Spain, Italy), though there are also

cases of devolution to local government (e.g. municipalities in the Netherlands since 2004).

The performance agreements that the U.S. government concludes with state governments in the administration of the Workforce Investment Act can be cited as an attempt to adapt the quasi-contract approach of performance management to the special tasks and problems of multi-level governance. It establishes a common performance accountability framework for programmes implemented by state and local governments and private sector partners. There is a small set of 'core' performance indicators for different target groups, with state and local governments free to include additional indicators beyond these minimum requirements (Eberts & Erickcek, 2002). In principle, the U.S. Department of Labor can suspend payments to states that fail to fulfil their obligations under the applicable performance agreement. Given the residual sovereignty of U.S. states and the political sensitivity of such a step, the performance agreements in fact define a bargaining relationship.

Accountability problems in multi-level governance in Canada are aggravated by the pattern of asymmetrical devolution through labour market development agreements: whereas some provinces have assumed full responsibility for active programmes within the funding and client eligibility guidelines of the national government ('full transfer'), in others the provinces are involved only in planning and actual delivery is the responsibility of the federal government ('co-management'). A national accountability framework (targets, performance measurement, reporting requirements, etc.) for this complex administrative structure is incorporated in the labour market development agreements concluded with the provinces (Rymes, 2003).

Market-based service provider contracts

Contracting-out is perhaps the most widespread form of privatisation in labour market policy. In contrast to quasi-contracts within the public service, contracting-out entails the use of for-profit providers and legal contracts. It aims at achieving heightened efficiency and flexibility by tendering employment services to external providers. The New Public Management approach strongly advocates contracting-out in the public sector, on the assumption that the market sector is more efficient than the public sector. The issue here is not whether the public sector should assume responsibility for providing a service but whether it should be provided by its own employees 'in house' or by external providers. Long practiced in many countries in the area of training and job-creation programmes, a contracting-out model increasingly is being used for the whole array of services, including even placement services, which in most countries is one of the few labour market services still predominantly provided 'in house'. In a few countries, governments now contract out the provision of comprehensive 're-integration services' ('trajectory', 'path') for some target groups to external providers (e.g. Australia, the Netherlands). Recent experience with contracting-out in the innovative market regimes in Australia, the United Kingdom and the Netherlands is discussed in Chapters 3, 5 and 7, respectively.

Contracting-out is a relatively new strategy that governments can choose in order to strengthen service provision. It entails the creation of a re-integration market and, on the basis of a tendering process, the direct purchase of re-integration services for clients from for-profit and non-profit private providers. A governance regime based on contracting-out — in a market or preferred-supplier service provision model — is a difficult strategy to implement, involving many choices and trade-offs, because such a re-integration market is not a regular market for two principal reasons. First, it has the complex structure of a quasi-market (Bartlett & Legrand, 1993; Considine, 2001; see also Chapters 7 and 11). In the quasi-market the client is not the purchaser; at the heart of the market is a triangular structure between client, purchaser and provider. Despite the fact that the purchasing public bodies often are large and can thereby pressure providers, they do not always have the incentives to exert this power in practice. The second reason is the low visibility of the quality of service. Employment services are an experience good: it is very hard, even after the service is provided, to determine the quality of service and what the contractor contributed.

There are many design issues that arise when governments introduce this type of contract. In order to discipline the agents, incentives have to be created (the most prominent example is payment for results, a key characteristic of market governance structures), as do information mechanisms (performance measurement, collection of data) and control mechanisms (entailing the costs of contract management; see also Bruttel, Chapter 10). Moreover, the purchaser has to decide on the scope of its direct control over the multiple steps — initial registration, detailed assessment, overcoming barriers to employability, the formulation of an action plan, vocational training, job search training and job placement — through which the jobseeker may be guided by the provider. The public body can choose to retain overall control and contract with private providers on the basis of specific tasks or, at the other extreme, limit the role of the public principal to recruiting jobseekers and determining their eligibility for services and have the private provider take over the whole process.

The specific challenges that public bodies encounter depend on the design options chosen for the key contracting tools that drive the quasi-market, including specific forms of competitive tender, pricing methods, performance payment regimes and client assessment tools. Countries considering contracting-out should focus on these key contracting tools and consider the impact they have on governance issues such as market regulation, accountability and effectiveness.

Elements of contracting-out and procurement contracts are (for an elaboration, see Struyven, 2004):

- Choice of tender form, tender procedures and criteria
In the tender form and procedures, the purchaser has to foster the following market conditions: a varied playing field, low barriers to entry, a level playing field (competition on equal terms) and maximum transparency. (See Chapter 2 for legal obligations.) The formulation of contracts can vary considerably from tender to tender; for example, they may be for specific target groups or for types of services.

- Client assessment tools, profiling
Public purchasers need to have knowledge about the chances that clients have of re-entering the labour market, with or without participation in labour market programmes. Ideally, profiling is a core element of the contract. Profiling is a standardised and validated instrument that is used for the identification of clients who have a greater risk of staying on benefits for a long time.

- Referral of clients
Various considerations play a role in the referral of clients. From the provider's point of view, the issues are whether they can choose among clients (either by deciding themselves whether to accept referred clients or by recruiting clients themselves) and/or whether a guaranteed number of clients will be referred to them, ensuring that their contracted capacity is filled. From the client's point of view, the issue is the jobseeker's freedom to choose a particular provider. From the principal's perspective, the issues include responsibility for the intake and referral process and for any incorrectly referred clients.

- Use of instruments
The question for government is how job-specific training in general — and skills-based guidance to the labour market — can be encouraged for those clients who need it. If the incentives and fees in the tender system are heavily weighted towards regular employment, the temptation is great for providers to help candidates find the 'fastest way into work'. The question is whether this job is suitable and sustainable. One major challenge is that providers are not inclined to invest in training their clients because it is not certain that this will actually result in subsequent placement and therefore in a fee for services rendered (Struyven, 2004).

- Outcomes, pricing and payment structure
The definition of outcomes is an important aspect of a tender model, particularly if the public body chooses the option of less process-oriented steering and more outcome-oriented steering. Strong incentives are preferably targeted on the outcome. Three aspects relating to the definition of outcomes need to be mentioned: the types of outcome to be counted, measurement and benchmarking (Struyven, 2004).
For the aspect of outcomes, the following questions are relevant: Is transfer to continued training or a subsequent step in a 'path' an outcome, or does an outcome only imply outflow into employment? Secondly, which types of employment, and what minimum duration, qualify as an employment outcome? For example, can voluntary work count as an employment outcome? The first question deals with whether to measure only outflow outcomes or transfer outcomes as well (i.e. transfers to another trajectory component or labour market measure). The second question deals with the definition of outflows. Employment, preferably long-term employment, is regarded as the ultimate objective of every service package. But what should be the definition of employment in terms of type of employment, type of contract and duration of employment? In general, vague definitions of outflow outcomes provide less of a guarantee of favourable long-term

employment and net employment effects. The benchmark (or target) is the third factor in the definition of net outcomes. Benchmarks can be varied by client group in order to combat creaming of the easier-to-place clients. Benchmark levels for outflow rates can vary in two ways: by type of outflow (the more permanent the employment, the lower the benchmark) and by target group (the 'more difficult' the target group, the lower the benchmark), or a combination of the two.

The principle of steering by results is expressed most prominently in the funding model. The first issue in the funding model is the type of contract. In their pure form, contracts are financed by result. In intermediate forms, the purchaser finances input, process and output. Two major types of payment structure exist: 'no cure, less pay' and 'no cure, no pay'. Under 'no cure, less pay', the total fee paid is related partly to the number of clients serviced and partly to the number of clients who enter employment. Under 'no cure, no pay', the total fee paid is directly proportional to the number of clients who enter employment. Advantages of outcome-related funding are a strong focus on the client, steering on placement and a small administrative burden for both parties. Disadvantages are creaming off of easy-to-place clients, restricted input on employability of clients and thinning of the market due to market concentration and lack of diversity and of innovation of services. A second issue in the payment structure or funding model is the timing of payment in terms of pre-financing and financing upon placement, possibly phased (Hoogtanders, 2003).

- **Monitoring**

Because publicly funded market-based contracts have to ensure an adequate level of equal treatment for jobseekers, in addition to taking a number of measures to ensure compliance with a contract and a code of conduct, performance needs to be monitored. Setting up a tender procedure has to go hand in hand with investment in a system of monitoring (both compliance with contracts and performance), data management and a quality assurance system. Compliance-monitoring examines whether the services are provided as envisaged in the contract and the financial and payment regulations. Performance-monitoring ideally is based on key performance indicators and a mix of methods (administrative data, survey data, risk assessment and site visits).

Client contracts

'Client contract' refers to a variety of arrangements. In some countries the jobseeker — or as he or she is generally referred to, the client — is granted the money that is considered necessary for re-integration. This funding can take the form of a grant to the jobseeker or, more indirectly, a voucher that can be cashed in at the counter of a service provider. Both instruments give the jobseeker an explicit claim on public funding, allowing him or her to spend it only for a particular service, but with a wide range of potential suppliers. As such, they contribute to client empowerment and provide an incentive for the market of employment services to improve its products. In practice, however, explicit vouchers in the domain of employment services are rare. Australia has

accounts, but these are to be administered by the provider (see Considine, Chapter 3). The United Kingdom (Employment Zones; see Finn, Chapter 5) and the Netherlands (see Westerveld & Faber, Chapter 8) have experimented with a personal re-integration budget, and Germany recently introduced placement and training vouchers (see Bruttel, Chapter 10).

The more common meaning of the term 'client contract' refers to the document that the jobseeker must sign in order to receive social benefits. In this sense, a contract is no more than an instrument to measure and control the willingness of the person on benefits to cooperate in finding a job (e.g. in the United Kingdom, Freedland & King, 2003; in the United States, Handler, 2002). In theory, client contracts can regulate all kinds of relations: between the individual and the government, the PES or a private for-profit service provider. In countries in which employment services are privatised, one might even wonder whether the arrangement is a two- or a three-party contract.

But there are other, more pressing questions with respect to client contracts. Questions, for instance, regarding their enforceability, accountability and the extent to which they are voluntary. Moreover, how do client contracts relate to the legal safeguards embedded in the welfare and social security law? This and other legal questions are dealt with in Chapter 2.

CONTRACTUALISM IN EMPLOYMENT SERVICES: KEY QUESTIONS

With the rapidly spreading use of contracting in employment services, the questions arise: Can it work and will it work? In search of greater efficiency and effectiveness in the provision of employment services, many governments have opened the door to their traditional, hierarchically structured employment services and have — backed by New Public Management theories on modern governance — embraced ideas of contestability and marketability. However, countries differ in the extent to which they expose themselves to the market. Countries such as Australia and the Netherlands are forerunners. They re-organised their systems and privatised major parts of the delivery system. Other countries retain their PES as a main provider and limit contracting to quasi-contracts within the public sector, while at the same time cautiously outsourcing selected labour market services to private providers.

According to the Organisation for Economic Co-operation and Development (OECD, 1995), New Public Management represents a global paradigm shift in the way in which the public sector is organised and controlled. In this vision the differences between countries are just that they are passing through different stages in the development towards a contractualist market model of the provision of employment services. Countries moving towards a market-based employment service should remove any barriers that could hinder progress and, learning from each other's failures, avoid mistakes and create the necessary institutions.

One can, however, question this perspective. Is a market-based contractualist governance model necessarily more efficient and effective? Does the contractualist

model attain its stated goals in countries in which it has been implemented? Country case studies must answer to these questions. But even if the model works for one country, one may question whether it can successfully be applied to other countries, as the global paradigm assumes. It is possible that different countries require a different governance structure suitable to their own particular circumstances. From a point of view that stresses context dependence (Pawson & Tilley, 1997), one can obtain better results by mapping the variety of contracting forms in the different countries and looking for appropriate arrangements in accordance with the composition of the client group, the structure of the labour market, the business cycle, the roles of the PES and so on. The broad array of design choices in contract models is, in this perspective, a point of departure.

The country studies in this volume highlight the combinations of national context and institutional arrangements in the domain of employment services. Their experiences with the provision of employment services through contractual arrangements either by the PES itself or external actors, the challenges confronted and the solutions adopted are at the heart of the country studies in the second part of this volume. What has been the impetus for the shift from steering in public contracts to the use of contracting-out and vouchers? When and why do countries choose complementary strategies rather than largely replace the PES with private providers?

One general conclusion can be drawn beforehand. All countries, including those that went furthest on the road to privatisation, have hybrid governance structures, mixtures of public provision for intake and market-type models such as contracting-out and vouchers for other services. Might there nevertheless be a case for arguing that conditions in the various countries are not that different, and that countries therefore, in order to be successful, do choose converging public reform measures? An important goal of the case studies in this book is to contribute to our knowledge of the similarities and differences in the use of contracting in the domain of publicly financed employment services.

Finally, it should be noted that the contributions in this volume are by no means an unqualified endorsement of market-based models. Indeed, problems that have surfaced in the shift from hierarchical coordination to market-based regimes have already led a few reformers to question the market model. For example, a Dutch interdepartmental study group advocates a 'radical return' of most of the agencies now operating at 'arm's length' back to government control (Interdepartementale Beleidsonderzoek [IBO], 2004). On the other hand, Sabel and O'Donnell argue for another type of governance structure in which central government limits its role and leaves responsibilities for policy design and implementation in the hands of local networks of stakeholders (2001, Chap. 3). An important argument for this change of views is the perception that the separation of responsibility for strategy and responsibility for implementation or, in more general terms, conception and execution may be untenable (Sabel, 2001, p. 128).

STRUCTURE OF THIS BOOK

The two introductory chapters (Part I) examine contractualism in employment services from a socio-economic and from a legal perspective, respectively. In this chapter, we have discussed the 'plethora of contractualist instruments' (Yeatman, 1998) in employment services in terms of governance regimes and three contract types: (a) government internal contracts: agency performance agreements or quasi-contracts within the public sector; (b) market-based service provider contracts: contracting-out and procurement of public services to/with private for-profit and non-profit providers; (c) client contracts.

In Chapter 2, Eichenhofer and Westerveld examine the consequences of the spread of contractualism from a legal perspective. Why are some of the arrangements of contracts viewed in a legal sense and others not, and what are the legal requirements and constraints that a government has to abide by when shaping its relationship through contracts with other public bodies, private service providers or jobseekers? Three topics in particular are discussed: the distinction between 'real' and 'quasi' contracts, the consequences of the contracting-out of public tasks or services under European law, and client contracts with individual jobseekers. Generally, jurists are very critical of the latter approach (e.g. Freedland & King, 2003; Handler, 2002). Eichenhofer and Westerveld opt for a more positive legal approach, considering, in the context of employment services, what the added value of such a 'contract with the client' could be.

The second section of the volume (Part II) consists of case studies of eight countries which analyse recent national experiences with one or more of the contract types for employment services. Three are Anglo-Saxon countries with liberal regimes (Australia, the United Kingdom, the United States), which together with the Netherlands have gone furthest in the privatisation of employment services. Four others are European continental regimes in which PES provision plays a strong role (Belgium, France, Germany and Finland). In all the contracting regimes we find individual client contracts. Finland is in this respect particularly interesting because of the explicit possibility of challenging individual contracts on constitutional grounds. The variety of experiences with contracting makes it possible to map the entire spectrum of issues in contractualism in employment services. The country studies focus on different types of contracts. Government internal contracts in the context of MBO regimes are the central topic in the chapters of Barbier (France), Konle-Seidle (Germany) and Struyven and Verhoest (Belgium). Simonin addresses traditional contracts with private providers in the niches of public employment service provision in France. Market-based service provider contracts are the dominant topic in the chapters by Considine (Australia), Brodtkin (United States), Finn (United Kingdom), Sol and Hoogtanders (the Netherlands) and Bruttel (Germany). The chapters by Freedland and King (United Kingdom), Westerveld and Faber (the Netherlands), Ebsen (Germany), Kerschen (France) and Sakslin and Keskitalo (Finland) are all dedicated to client contracting. The last chapter by Sol and Westerveld (Part III) reviews the findings of the country studies and addresses the key questions discussed above.

REFERENCES

- Arrow, K. J. (1985). Informational structure of the firm. *American Economic Review*, 75(2), 303-307.
- Barney, J. B., & Hesterly, W. (1996). Organisational economics: Understanding the relationship between organisations and economic analysis. In S. R. Clegg, C. Hardy, & W. R. Nord (Eds.), *Handbook of organisational studies* (pp. 115-147). London: Sage.
- Barney, J. B., & Ouchi, W. G. (1986). *Organizational economics: Toward a new paradigm for understanding and studying organizations*. San Francisco: Jossey-Bass.
- Bartlett, W., & Legrand, J. (1993). *Quasi markets and social policy*. London: Macmillan.
- Considine, M. (2001). *Enterprising states: The public management of welfare-to-work*. Melbourne, Australia: Cambridge University Press.
- Considine, M. (2003, August). *Contracts, networks and quasi-markets for Australian employment services*. Paper presented at the conference Contractualism in Employment Services, University of Amsterdam.
- Courty, P., & Marschke, G. (1996). Moral hazard under incentive systems: The case of a federal bureaucracy. In G. D. Libecap (Ed.), *Advances in the study of entrepreneurship, innovation, and economic growth*, Greenwich, CT: JAI Press, 157-190.
- Courty, P., & Marschke, G. (1997). Measuring government performance: Lessons from a federal job-training program. *American Economic Review*, 87, 383-388.
- Davies, A. C. L. (2001). *Accountability: A public law analysis of government by contract*. New York: Oxford University Press.
- De Koning, J. (2004). Wat niet weet, wat niet deert: over de decentralisatie en uitbesteding van het arbeidsmarktbeleid. Oratie 2 september 2003. *OVER-WERK Tijdschrift van het Steunpunt WAV*, 1-2/2004, 11-18.
- Eberts, R., & Erickcek, G. (2002, January). *The role of partnerships in economic development and labor markets in the United States* (Staff Working Paper No. 02-75). Kalamazoo, MI: Upjohn Institute for Employment Research.
- Ferris, J. M., & Graddy, E. A. (1996, July). *Institutional economics and government contracting: Lessons for the New Public Management*. Paper presented at the conference New Public Management in International Perspective, Institute of Public Finance and Fiscal Law, St Gallen, Switzerland.
- Freedland, M., & King, D. (2003). Contractual governance and illiberal contracts: Some problems of contractualism as an instrument of behaviour management by agencies of government. *Cambridge Journal of Economics*, 27(3), 465-477.
- Handler, J. (2002). *Myth and ceremony in workfare: Rights, contracts, and client satisfaction* (UCLA Research Paper No. 02-21). Los Angeles: University of California at Los Angeles, School of Law.
- Hart, O. (2003). Incomplete contracts and public ownership: Remarks, and an application to public-private partnerships. *Economic Journal*, 113, C69-C76.
- Hart, O., Shleifer, A., & Vishny, R. (1997). The proper scope of government: Theory and an application to prisons. *Quarterly Journal of Economics*, 112(4), 1127-1161.
- Hood, C. (1991). A public management for all seasons. *Public Administration*, 69, 3-19.
- Hoogtanders, Y. (2003). *Resultaatsfinanciering van reïntegratietrajecten*. The Hague, the Netherlands: Stichting Stimulansz.
- Interdepartementale Beleidsonderzoek (IBO). (2004). *Een herkenbare staat: investeren in de overhead* [A recognisable state: Investing in the government] (IBO No. 1). The Hague, the Netherlands: Author.
- King, S., & Pitchford, R. (1998). Privatisation in Australia: Understanding the incentives in public and private firms. *The Australian Economic Review*, 31(4), 313-328.
- Le Grand, J. (2002). *Models of public service provision: Command and control, networks or quasi-markets?* Paper presented at the 'Public Services Productivity' seminar held in HM Treasury, London. Available from the HM Treasury Web site (pp. 15-18): <http://www.hm-treasury.gov.uk/media/69F/2A/adproduct378kb03.pdf>
- Mayntz, R. (Ed.). (1983). *Implementation politischer Programme II. Ansätze zur Theoriebildung*. Opladen, Germany: Westdeutscher Verlag.
- Mayntz, R. (2004, March). *Governance Theory als fortentwickelte Steuerungstheorie?* (MPIfG Working Paper No. 04/1). Cologne, Germany: Max-Planck-Institut für Gesellschaftsforschung.
- Miller, P., & Rose, N. (1990). Governing economic life. *Economy and Society*, 19(1), 1-31.
- Mosley, H., Schütz, H., & Breyer, N. (2001). *Management by objectives in European public employment services* (Discussion Paper FSI01-203). Berlin: Wissenschaftszentrum Berlin für Sozialforschung (Social Science Research Centre).
- Organisation for Economic Co-operation and Development (OECD). (1995). *Governance in transition*. Paris: OECD.
- Osborne, D., & Gaebler, T. (1992). *Reinventing government: How the entrepreneurial spirit is transforming the public sector*. Reading, MA: Addison-Wesley.
- Pawson, R., & Tilley, N. (1997). *Realistic evaluation*. London: Sage Publications.
- Ramia, G., & Carney, T. (2000). Contractualism, managerialism and welfare: The Australian experiment with a marketised employment services network. *Policy & Politics*, 29(1), 59-83.
- Rhodes, R. A. W. (1999). *Understanding governance: Comparing public sector reform in Britain and Denmark* (Demokratiprojektets Arbejdsrapportserie No. 17). Copenhagen, Denmark: Københavns Universitet, Institut for Statskundskab.
- Richards, S. (1994). Devolving public management, centralizing public policy. *Oxford Review of Economic Policy*, 10(3), 40-50.
- Rymes, D. (2003). Canada: Partnerships across levels. In OECD (Ed.), *Managing decentralisation: A new role for labour market policy*. Paris: OECD.

- Sabel, C. F. (2001). A quiet revolution of democratic governance: Towards democratic experimentalism. In OECD (Ed.), *Governance in the twenty-first century* (pp. 121–148). Paris: OECD.
- Sabel, C. F., & O'Donnell, R. (2001). Democratic experimentalism: What to do about wicked problems after Whitehall. In OECD (Ed.), *Devolution and globalisation: Implications for local decision-makers* (pp. 67–90). Paris: OECD.
- Schmid, G., O'Reilly, J., Schömann, K. (Eds.). (1996). *International handbook of labour market policy and evaluation*. Cheltenham, UK: Edward Elgar.
- Struyven, L. (2004). *Design choices in market competition for employment services for the long-term unemployed* (OECD Social, Employment and Migration Working Papers No. 21). Paris: OECD.
- Williamson, O. E. (1985). *The economic institutions of capitalism: Firms, markets, relational contracting*. New York: Free Press.
- World Bank. (1995). *Bureaucrats in business: The economics and politics of government ownership* (World Bank Report No. 15037). New York: Oxford University Press.
- Yeatman, A. (1995). Interpreting contemporary contractualism. In J. Boston (Ed.), *The state under contract* (pp. 124–139). Wellington, New Zealand: Bridget Williams Books.
- Yeatman, A. (1997). Contract, status and personhood. In G. Davis, B. Sullivan, & A. Yeatman (Eds.), *The new contractualism?* (pp. 39–56). Nathan, Australia: Griffith University, Centre for Australian Public Sector Management.
- Yeatman, A. (1998). Interpreting contemporary contractualism. In M. Dean & B. Hindess (Eds.), *Governing Australia: Studies in contemporary rationalities of government* (pp. 227–241). Cambridge, UK: Cambridge University Press.

CHAPTER 2

Contractualism: A Legal Perspective

EBERHARD EICHENHOFER & MIES WESTERVELD

'Give a hand, not a handout!' With these words John F. Kennedy introduced a new understanding of social policy. The emphasis was to be on teaching the individual to help himself, not on simply feeding the needy. The driving idea behind today's social policy reforms can be summarised with Anthony Giddens's observation: 'No rights without responsibilities!' (1998, p. 65). These remarks from different eras help elucidate the impetus behind the activating welfare state.¹ This form of welfare state aims to assist beneficiaries by providing services that foster their independence, so that they will not require benefit payments in the future. In this way of thinking about the purpose of welfare, a paternalist attitude is replaced by a libertarian one: public support should be delivered as an aid to self-help.

The concept of the contract assumes a key role in this strategy. In this form of new governance, one-sided bureaucratic and hierarchical public governance is replaced by contracts, state help assumes the techniques of private enterprise and public bodies start to behave as market actors. As a result, the Public Employment Service (PES) becomes an agency at arm's length, with output targets that are set by the politicians, who in turn have politically imposed output targets.

Contractualism as a management technique is being used in the reform of labour market policies in many countries of the Western world (Carney & Ramia, 2002). These reforms can be summarised as an effort to replace the traditional, bureaucratic and hierarchical type of governance, based upon statutory rules and striving for a 'standardised, one-size-fits-all bureaucratic approach', with a new type of public administration (Yeatman, 2000, pp. 156, 165). An analysis of welfare state reforms reveals 'a plethora of contractualist instruments of public management' (Yeatman,

¹ On this, see Giddens, 1994, p. 18.; Gilbert, 1995, pp. 151, 165; Gilbert, 1998, pp. 8, 12; Jordan, 1998, p. 40.